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SUBJECT: Mongolia Scenesetter for Codel Kolbe

¶1. We look forward to hosting you in early September, and to showing you how U.S. taxpayer dollars are being used here to benefit the Mongolian and American people. Your visit here will continue a stellar year for high-level bilateral engagement. Over the last year, visitors have included: Speaker Hastert and delegation and Rep. Leach (both in August 2005); Secretary of Defense Rumsfeld (October); the President, First Lady and Secretary of State (November); and Secretary of Agriculture Johanns (in July, leading a Presidential Delegation for the 800th anniversary of Mongolia's establishment as a state). A HIRC staffdel will be here 8/22-26 to examine progress toward an MCA Compact with Mongolia.

A New Friend

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¶2. Since 1990, Mongolia has become a friend for the U.S. in Northeast Asia. Mongolia has looked to us (and, to a lesser extent, Japan, South Korea, Turkey, Germany and others) as "third neighbors." Mongolia sees good relations with us and other third neighbors as a partial antidote to dependency on, or pressure from, its two immediate neighbors, Russia and China. Both China and Russia are eager to participate in the development of Mongolia's mineral resources. There is a historical antipathy toward China, which ruled Mongolia for two centuries until 1921, and a concern about being economically overwhelmed by the nearby colossus. Feelings about Russia are warmer, with gratitude for Russia's aid in escaping China's clutches and for assistance during the socialist era, but also some bitterness about the sudden withdrawal of Russian aid, which caused tremendous economic hardship in Mongolia in the early 1990s.

¶3. The July 2004 Joint US-Mongolia Presidential statement describes U.S. relations with Mongolia as a "comprehensive partnership" based on common values and shared interests. Mongolia's "strategic" value for the United States is not in the classic security/military sense.

Rather, Mongolia serves as an example - and role model - of a smooth and successful transition from authoritarian communism to democracy and a market economy. The fact that Mongolia is undertaking simultaneous political and economic reform and has, over the past 15 years made many of the right choices, made it eligible for MCA funding in 2004. Mongolia became a member of the Communities of Democracies convening group in the last year.

¶4. Our military-military relations with Mongolia are good, and based on assisting Mongolia's defense reform and enhanced capacity to provide elite peacekeeping forces. U.S. mil-mil aid has been and will be a key part of that effort. The Global Peace Support Operations Initiative (GPOI)-supported "Khaan Quest" multilateral peacekeeping training exercise will wrap up a few days before your visit. Mongolia has been a stalwart supporter in the Global War on Terrorism, and has had troops on the ground in Iraq and Afghanistan since 2003. It has confirmed its intent to send a 7th rotation to Iraq in September, though we are still discussing important details.

Mongolian soldiers are guarding the UN war crimes tribunal in Sierra Leone, and Mongolia sent a detachment to the NATO mission in

Kosovo last December.

## Still In Transition

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**¶5.** While Mongolia has come a long way since 1990, its political and economic transitions remain incomplete. Elections have been largely free and fair, and three of the four parliamentary elections since 1992 have resulted in changes of power. But Mongolia has yet to institutionalize democracy and rule of law. Lack of transparency and corruption (conflict of interest) are major problems. The Mongolian People's Revolutionary Party (MPRP), the self-described social democratic successor to the Communist Party, retains major advantages in cohesion and organization over its rivals. That can lead to lopsided results, as in the 2000 parliamentary elections, when the MPRP parlayed 53% of the popular vote against divided opponents into 72 out of 76 seats.

**¶6.** In the 2004 elections, the popular vote split was nearly the same, but an opposition coalition won nearly half of the seats. With no party capable of forming a government on its own, the elections produced a coalition government between the MPRP and the Democratic Party (DP). The first coalition, led by DP Prime Minister Elbegdorj, was voted out in January 2006. The DP then boycotted the formation of a new government. The current government is a weak and dysfunctional coalition of several MPRP factions and several tiny political parties (see para X).

**¶7.** Economically, Mongolia faces daunting disadvantages due to its landlocked status, severe continental climate, and a population of 2.8 million sparsely scattered over a territory the size of Alaska. Some 40% of the population now live in the capital, the result of an influx of poor herders deciding to try their luck in Ulaanbaatar; however, another 40% of the population still relies on semi-nomadic herding. Unemployment is high, and there is a high rate of male alcoholism. Economic growth was 10% in 2004 and 6% in 2005, but this was largely based on high world mineral prices and increased mining production, and ill-distributed. A recent USAID-financed study concluded that the shadow economy is about half again the size of the official one. While most of the economy is in private hands, key industries remain government-owned. Not only are these industries poorly operated and bankrupt, they also distort the market. In practice, early privatization often most benefited members of the political elite. Privatization efforts have stalled since 2004. Corruption is the biggest business problem mentioned by foreign and domestic businessmen, and public perceptions of rising corruption help fuel resentments caused by growing wealth disparities.

## Current Government: Unpopular, Rumors

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**¶8.** The current government was formed in January, after the MPRP withdrew its ministers from the "grand coalition" government with the Democratic Party formed in September 2004. Its poll numbers are dismal (in the 25% approval range), and Prime Minister Enkhbold did not even make the list of the country's ten most prominent politicians in an April survey. The government's ability to show leadership amid an atmosphere of populism and nationalism (centered on expensive social welfare promises and sentiment over foreigners profiting from Mongolia's mineral resources) is still in doubt. The government is MPRP-led, but includes four of the other six political parties with seats in the State Great Hural (parliament); that inclusiveness is part of its problem, since there is some Cabinet indiscipline attendant to the various ministers positioning their parties with the public for the 2008 elections. As with its predecessor, rumors about government stability are recurrent, but it seems a sure bet that some form of an MPRP-led government will be in place until 2008.

## U.S. and Other Foreign Aid

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**¶9.** On a per capita basis, Mongolia has received relatively high levels of aid. From 1990-2004, official development assistance to Mongolia from bilateral and multilateral donors was \$2.7 billion, or nearly \$1000 per person. Since 1991, Japan has been the largest bilateral donor. Total USAID assistance to Mongolia from 1991

through 2005 has been about \$150 million, all in grant form. In the early 1990s, USAID assistance was instrumental in staving off collapse of the energy sector following the Russian withdrawal. The current USAID program emphasizes two main themes: sustainable, private sector-led economic growth; and more effective and accountable governance. About two-thirds of the current (2006) budget of \$7.5 million a year promotes economic growth, and focuses on macroeconomic policy reform, energy sector commercialization, financial sector reform, strengthening the cashmere and tourism industries, and providing business development services to small and medium enterprises in both rural and urban areas. USAID has had a number of resounding successes in promoting private sector-led economic growth, as most recently evidenced by Parliamentary passage of the most dramatic overhaul of the Mongolian tax system since the Russians left. The other third focuses on judicial sector reform, electoral reform, parliamentary reform, and anti-corruption work. Through USAID support in democracy and governance, every court in the country has been automated, proportional representation has been restored, and a new anti-corruption law is in place.

¶10. In most years since 1993, the United States Department of Agriculture has provided food aid to Mongolia under the Food for Progress and 416(b) programs. The monetized proceeds of the food aid (\$3.7 million in 2005) are currently used to support programs bolstering entrepreneurship, herder diversification, better veterinary services, and disaster relief. The United States has also supported defense reform and an increased capacity by Mongolia's armed forces to participate in international peacekeeping operations. Mongolia has contributed small numbers of troops to coalition operations in Iraq and Afghanistan since 2003, gaining experience which enabled it to deploy armed peacekeepers to both UN and NATO peacekeeping missions in 2005.

¶11. The Peace Corps currently has almost 100 volunteers in Mongolia. They are engaged primarily in English teaching and teacher training activities. At the request of the Government of Mongolia, the Peace Corps has developed programs in the areas of public health and the environment.

#### Millennium Challenge Account Process

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¶12. In a letter dated July 31, 2006, MCC CEO Danilovich officially informed the Mongolians that, based on the complexity of the Mongolian proposal and the slow pace of work on the Mongolian side, MCC is "looking at late spring, 2007, as the target date" for a Compact. Danilovich's letter was in response to a July 21 letter from Amb. Bold complaining about the delay in reaching a Compact. The GOM, which hoped to sign a Compact during 2006 (the 800th anniversary) is disappointed and frustrated at what it perceives as unnecessary delay in reaching a Compact.

¶13. Mongolia was one of the original 16 MCC eligible countries in 2004. From the outset, Mongolian officials had unrealistic expectations that hundreds of millions of dollars would soon be disbursed on the basis of sketchy proposals. Many Mongolians also made the unfortunate and mistaken assumption that MCA was a reward for joining the Coalition in Iraq. We have consistently denied this linkage in public and private, but the perception persists.

¶14. On the Mongolian side, progress and process have been hampered by a serious shortage of western-educated, trained professional and technical capacity, and a propensity by decision makers to seek consensus rather than set priorities and make hard choices. These factors combined to delay submission of a proposal by Mongolia - until October 2005. These factors continue to slow the process. The proposal submitted was not only complex, but also not well justified or fully fleshed out. MCC began its due diligence in November 2005 and will continue this phase through the end of 2006.

¶15. Eight hundred years after Genghis Khan (or "Chinggis Khaan" to Mongolians), Mongolia is a land justly famous for its hospitality and its beauty. We're glad that your time in Mongolia will allow you to sample a bit of both, and look forward to seeing you in three weeks.